Can the Crisis be brought under Control?

[This is a letter I sent to friends on Oct. 11, 2008, along with a Reuters' news report (appended below). –S.H.]

Hi everybody,

For a long time I have been arguing that:

1) In the capitalist-imperialist era (since the late 1800s) the capitalist industrial cycle has "split in two" (i.e. into fairly mild recessions every 5 to 10 years, with major depressions much less frequently).

2) That we are approaching the second of those infrequent depressions (the first being the Great Depression of the 1930s of course).

3) That fairly soon one of the periodic recessions will prove to be *uncontrollable* and will develop into that new depression.

In light of that theory, and in light of the current extreme financial crisis, where do we stand today?

Obviously, the current financial crisis has really gotten out of hand, and so far—at least—has proven to be quite uncontrollable. (See article attached below.) It really looks to me like the ruling classes of the world will be lucky to eventually bring it under control in a situation other than that of a developing depression.

However, so far we are only in a mild recession in the U.S. and with only mild recessions developing (so far) in a number of other countries (Japan and several in Europe). According to the U.S. government we are not yet officially in a recession at all! But by now just about everyone knows better. And that's without taking into consideration the systematic lying the government does about actual GDP, unemployment, inflation, capacity utilization levels, and other statistics.

Even many bourgeois economists, however, are predicting that it is inevitable that the current mild recession will get very much worse. A few still disagree, such as James Cooper in the current issue of *Business Week* who expects only a "mild", if prolonged, recession. But most of them are predicting *both* a prolonged and severe recession, and I am convinced that they are right about this. The real question is not whether the current *financial* crisis can be brought under control (it certainly will be eventually), but whether this rapidly intensifying U.S. and world *recession* can be contained and prevented from developing into a full-scale depression. But it may be that most people will not even be able to *think* about that possibility until the financial crisis ends and the recession gets much worse than now.

It is important to understand that *financial* crises and *economic* crises are not the same thing! Financial crises occasionally occur without leading to significant acute economic crises. One example was the 1987 stock market crash in the U.S. But more typically crises in the financial sphere are *part* of a larger and more fundamental economic crisis. (Virtually all financial crises are at least symptoms of an underlying and developing economic crisis.)

A financial crisis can often play a major role in the development of the deeper, underlying economic crisis. In the second half of 1929 there were already signs of a developing recession. At the time of the stock market crash in October the Fed's index of industrial production had already fallen to 117 from 126 four months earlier. [J. K. Galbraith, *The Great Crash: 1929*, chapter V.] But the economy didn't fall apart until the stock market crashed. That led to a chain reaction of economic contradictions coming to their head, and the real economy spiraled down and down until the depths it reached in 1933.

It's a fair guess that something like that might be happening again now.

The biggest positive difference between the 1929 situation and that of today is of course that the Fed and the government in general have the experience of the Great Depression of the 1930s to guide them away from making the same mistakes. (And many actual mistakes *were* made by the Fed and government in the Great Depression, including many actions—and inactions!—that made things worse.)

But there are also many very negative differences between 1929 and today. First of all, the financial crisis today is much, *much* worse than it was in 1929! But more fundamentally, the underlying economic contradictions which led to the Great Depression have also been built up to a *much* greater level than they were in 1929.

In 1929 the proper government policies just might have prevented the already developing recession from developing into a full-scale depression (immediately anyway). And the Depression, once started could have been at least "interrupted" fairly soon if much greater and much earlier Keynesian deficit financing had been used. (As it was in Sweden and Germany.)

But the problem today is that the U.S. and other governments have already been using these Keynesian and other methods for *decades* in order to keep the economy limping along even at the fairly slow pace it has been. In other words, they have been using the medicine to "cure" a depression in order to prevent one from occurring. And now that they really need that medicine more than ever before, the bottle is almost empty!

I told my sister a few days ago that I thought the odds of a new depression developing out of all this were "only" 50-50. But in thinking about it some more, and in watching the further ineptness of the government in even trying to bring the initial financial crisis under control, I think it is probably wise to raise those odds to at least 60-40.

And if this current financial and economic crisis *is* eventually brought under some sort of control, it will definitely be only in the form of a shallow and short recovery. And soon another recession will develop. And then another. If the currently developing recession doesn't soon spin totally out of control, then one of the next few is virtually certain to.

Scott Harrison

IMF warns of financial meltdown as crisis rages

By Lesley Wroughton and Emily Kaiser, Reuters
2 hours ago [Saturday Oct. 11, 2008]

WASHINGTON — The International Monetary Fund warned on Saturday that debt-ridden banks were pushing the global financial system to the brink of meltdown and rich nations had so far failed to restore confidence.

The United States appealed for patience as world leaders raced to stabilize financial markets and avert the deepest global recession in decades, but the IMF said more steps would be needed in the coming months.

"Intensifying solvency concerns about a number of the largest U.S.-based and European financial institutions have pushed the global financial system to the brink of systemic meltdown," IMF chief Dominique Strauss-Kahn said.

President George W. Bush huddled with Group of Seven economic chiefs and officials from the IMF and World Bank, and said top industrial nations grasped the gravity of the crisis and would work together to solve it.

"I'm confident that the world's major economies can overcome the challenges we face," Bush said, adding that Washington was working as fast as possible to implement a $700 billion financial bailout package approved a week ago.

"The benefits will not be realized overnight, but as these actions take effect, they will help restore stability to our markets and confidence to our financial institutions."

Confidence has been in short supply and panic has swept through global markets, driving stocks to a five-year low on Friday and prompting banks to hoard cash. That has choked off lending to businesses and households, threatening to turn a global economic slowdown into a dangerously deep recession.

U.S. Treasury Secretary Henry Paulson said risks to the global economy were "the most serious and challenging in recent memory."

NEXT STEPS

The world's rich nations vowed on Friday to take all necessary steps to unfreeze credit markets and ensure banks can raise money but they offered no specifics on a collective course of action to avert the recession threat.

In a surprisingly brief statement after a 3-1/2 hour meeting, the G7 stopped short of backing a British plan to guarantee lending between banks, something many on Wall Street saw as vital to end growing market panic.

Kenneth Rogoff, a Harvard University professor and former IMF chief economist, said the G7 would have been better served adopting some version of the British plan so that banks would feel confident enough to loosen their grip on lending.

"Saying that they'll take all steps necessary leaves hanging the question of whether they know what is best and necessary," he told Reuters. "It was a signature moment for the G7. I think markets are going to be very disappointed."

European Central Bank President Jean-Claude Trichet said markets needed time to digest a series of dramatic steps taken by world central banks in recent days, including pouring billions of dollars into financial markets and lowering interest rates in the broadest coordinated cut on record.

An emergency meeting of euro zone leaders on Sunday will discuss a bank rescue package taking Britain's initiative as a reference point, a source close to the French presidency said, even though as a non-euro member Britain would not attend.

French President Nicolas Sarkozy said euro zone countries were working on a joint solution, and he planned to meet with British Prime Minister Gordon Brown shortly before Sunday's euro zone gathering.

Britain's rescue plan, launched last week, makes available 50 billion pounds ($86 billion) of taxpayers' money for injection into its banks and, crucially, to underwrite interbank lending which has all but frozen around the globe.

Germany was also considering injecting capital into its banks, Chancellor Angela Merkel said on Saturday.

WORKING AROUND THE CLOCK

The U.S. government was scrambling to put together a plan to buy direct stakes in American banks to shore up balance sheets riddled with heavy credit losses from the 14-month crisis that began with failing U.S. mortgage loans.

U.S. Treasury's Paulson said it was "naive" to think that the G7 would endorse a one-size-fits-all approach to ending the credit crisis because there were major differences between the countries and their financial systems.

But even as Paulson and his fellow finance ministers insisted that they were working as fast as possible, there were signs the economy was credit-starved and deteriorating fast.

The U.S. auto sector has been particularly hard-hit. General Motors has had talks with smaller rival Chrysler LLC about a merger that would combine the No. 1 and No. 3 American automakers at a time when both are struggling to cut costs and shore up cash, according to a source briefed on the matter.

Financial weekly Barron's reported that GM was preparing to approach the U.S. Federal Reserve about borrowing money directly from the central bank because the logjam in credit markets had shut it out of other kinds of borrowing.

Paulson said the U.S. government would buy shares of financial institutions if necessary to halt market turmoil that has wiped out trillions of dollars of wealth.

"We're going to do it as we can do it in a proper way that will be effective. Trust me, we're not wasting time, we're working around the clock," Paulson said late on Friday after the G7 meeting broke up.

(Reporting by G7 team; Writing by Emily Kaiser; Editing by Tim Ahmann)

© 2008 Thomson Reuters.